



TAX EVASION, STATE CAPACITY AND TRUST IN TRANSITIONAL COUNTRIES: THE CASE OF CROATIA

Predrag BEJAKOVIĆ
Institute for Public Finance, Zagreb

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Tax evasion is a serious problem for most countries in transition exemplifying for Croatia in particular the difficulties of the state in performing its basic duties. This paper examines the problems of tax collection and their relation to the capacities of the state. Attention is also given to the relationship between the taxation system and tax morality or compliance as well as analysis on the extent of tax evasion, types of tax morality and the different cultures of trust and distrust in Croatia. The final section provides conclusions and some policy recommendations.

Keywords: tax evasion, tax culture, state capacity, Croatia

✉ Predrag Bejaković, Institute for Public Finance,
Smičiklasova 21, 10 000 Zagreb, Croatia.
E-mail: predrag@ijf.hr

INTRODUCTION

Tax evasion is a serious problem for most countries in transition, especially having in mind the huge expectation of the population for different kinds of public goods and the limited state capacities for collecting the required public revenues. The situation is further endangered by the low level of trust towards the state which could lead to deterioration in the (already small) level of social capital and low participation in civil society. All these are likely to reduce opportunities for citizens to influence policies.

The paper is divided into five sections: This introduction (Section 1), while Section 2 discusses problems with tax col-

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lection and how these problems relate to state capacities. Section 3 examines the relationship between the taxation system and tax morality or tax compliance, while the analysis on the extent of tax evasion or types of tax morality and different cultures of trust and distrust in Croatia is provided in Section 4. The article finishes (Section 5) with conclusions and some policy recommendations.

PROBLEMS WITH TAX COLLECTION AND HOW THESE PROBLEMS RELATE TO STATE CAPACITIES

In Croatia the most important source of tax revenues is VAT, followed by excise taxes. Personal income and company taxes also exist but their importance as sources of public revenues is lower as they contribute around 20% of all tax revenues or less than 10% of GDP. One should stress that social security contributions are an important source of public revenues (and a heavy burden for tax payers) but also very prone to evasion. Thus, it is necessary to analyse the tax burden and the causes of tax evasion for the whole system of taxes and social contributions.

Madžarević-Šujster (2002), given certain assumptions, carried out simulations of the tax and social welfare contributions for the period from 1994 to 2000. She estimates that the amount of evasion of income tax and surtax grew from 1.5% of GDP in 1994 to 2.7% in 2000, while evasion of tax and contributions as a percentage of GDP rose from 4.3% to 5.9%. Thus, a large chunk of income goes unreported and untaxed. An obvious consequence of tax evasion is the erosion of the tax base. Tax evasion also affects the government's ability to distribute the tax burden fairly: people who under report their income may be unfairly receiving benefits that the government had intended to provide only to those who earn less than a certain amount.

The reasons for significant evasion are manifold and we will try to mention and explain some of the most important ones:

In Croatia there is a very weak consciousness of some of the basic factors of public finance (that are well known in the West). Firstly, there is public lack of knowledge of the phenomenon that *there is no such thing as a free lunch*. Although declining (Štulhofer and Rimac, 2002) there is still highly widespread and/or deeply rooted paternalism in Croatia – a belief that government should (or is obliged to and can) solve all the existential problems of its citizens. It is widely believed that the government should and could provide different types of public good and pay from its own sources. Obviously, citizens forget that the government only has money that comes from tax payers.

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Furthermore, there is little understanding by the general public and no serious explanation or regular information campaign from the government side on the *costs of public goods*. One should not expect that people will cease to use different kinds of public goods once they are informed about their costs, but possibly they may be more willing to economize in their use. This is particularly true if citizens (or users) are increasingly obliged to co-finance some of the public goods provided. This is not currently the case in Croatia (for example, higher tuition fees could contribute to shorter average periods of study or users' increased contribution to costs could lower the over-consumption of medicines).

One should not always blame the citizens. Some of the factors are linked with lack of experience in the payment of taxes: until recently (especially in the former Yugoslavia) the most important tax forms were consumption taxes (sales tax and excise) – where the tax obligation is *hidden* and included in the retail price. Also in the former Yugoslavia there was a serious (nearly complete) lack of public discussion on fiscal issues. Decisions on financing were made almost exclusively by state central bodies, and similar practices existed in the newly formed independent Croatia. Thus, the citizens are mostly badly informed and/or insufficiently educated on the different issues of public finance.

Citizens' opinions and perceptions are poor on the availability, fairness and quality of public goods. For example, the judicial arm of government is deemed extremely ineffective and slow. Users complain about the inefficient provision of medical services, stressing increased costs and expenditures and are dissatisfied with the quality, accessibility, affordability and speed of the services provided. Furthermore, there is a general lack of confidence in the public pensions system (of intergenerational solidarity). Young workers are forced to pay a significant part (15%) of their gross income into a public pension system that is on the verge of bankruptcy. They do not believe that the existing system will provide them with the corresponding amount of material security in their old age.

The general public believes that the situation with welfare programmes' efficiency is particularly unfavourable because, due to limited availability, sources are mostly not very well targeted towards the most vulnerable groups in society, while relatively well targeted social assistance programmes are small and fragmented. There is the impression that the Government spends a large share of GDP on various social programmes but achieves little real redistribution and instead of reducing inequality, the general welfare system acts to enhance it. Thus, there is a generalised intuition that welfare transfers represent a transfer to the relatively well-off, and fail to ade-

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quately protect the elderly and disabled from falling into poverty (Roller, 2009).

Legislation, especially related to finance, budget and taxes *is not sufficiently clear and is exposed to constant changes*. According to the OECD (2005), the perception of the stability and transparency of the tax system is regarded as far from satisfactory and even deteriorating. Legal provisions are often inappropriate, inconsistent and not easily applicable and equally unintelligible both to those whose behaviour they are to regulate and to the courts and other bodies that have to apply them. To the extent that this is possible, the normative environment should be stable – frequent changes that introduce legal uncertainty and contribute to lack of efficiency are to be avoided (Uzelac, 2004). The constant amending of legislation is not a good approach to the creation of an efficient battle against tax evasion and the respect of the law. As regards legislation, it is necessary to check whether it is effective or not through its implementation prior to any process of amendment. One might guess that in Croatia very often the problem is not in the legislation itself, but in its implementation, i.e. non-implementation.

There is a false impression held by the general public that the tax system is not progressive enough (although it is very progressive – Kesner-Škreb and Madžarević-Šujster, 2003). In the situation outlined and with strong and constant pressures from different lobbying groups, one should not be surprised that the tax laws and system are characterized by permanent changes – such as the introduction of new tax rates and increasing (almost multiplying) different tax deductions, allowances, exemptions, lower VAT rates for particular goods and services, etc.

That the budget process in Croatia is not sufficiently transparent is clearly shown in the Open Budget Questionnaire (Open Budget Initiative, 2005). Croatia's scores are uneven, indicating mostly positive practices in the area of "monitoring and evaluation reports", but negative or mostly negative practices in the other two major categories: "executive budget documents" and "encouraging public and legislative involvement". At the national level, Croatia's deliberation over public finance can be characterized as a closed system with power delegated almost exclusively to the executive branch. In a situation in which even Parliamentary members complain about having a lack of influence over national public finance issues, the influence of members of the general public is obviously even weaker. Thus, there is a serious lack of public debate about the proposed tax law, which could/should be improved by better information, the democratization of the whole political process and education of the electorate.¹

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In Croatia there is widespread dissatisfaction with public administration and the growing perception that it is inadequate and is one of the key impediments to the successful transition from a centralized system towards a more democratic society and a free-market economy. Public administration still remains one of the weakest links in the institutional development transition process and thus an obstacle to economic growth. Public administration in Croatia does not reach the level of institutional development required for the effective implementation of many newly accepted laws and regulations. Its poor efficiency is linked with the lower wages of highly educated employees in comparison to the private sector; with the lack of strict internal anti-corruption control; an inheritance of paternalism and a high level of patronage and non-merit based recruitment. There are constant reform efforts but they are insufficient or very slow (Bađun, 2004, 2009). All this contributes to the dissatisfaction of citizens and their unwillingness to pay taxes as a source for the wages and salaries of employees in public and state administration.

The perception of tax administration among the Croatian people is that it is inefficient, ineffective, and corruptive.² One should underline that in comparison to many other, especially transitional countries, the Croatian Tax administration is relatively efficient, skilful and well-equipped.³ But, the collection and control functions of the tax and customs administrations remain weak and procedures to effectively prosecute tax fraud need to be strengthened. Croatia needs to modernize its tax administration significantly in order to improve tax collection and compliance.

In Croatia, as in many other transitional countries, because of the absence of democratic, economic and regulatory institutions and the lack of experience in the payment of taxes (with simultaneous large discretionary rights by officials and a profligate government) it is very likely that there will be avoidance and evasion of taxes, corruption, extortion and other illegalities. There are many causes such as the low level of consciousness and knowledge about public finance and the cost of the public good, dissatisfaction with the quality and availability of public services, inadequate or inefficient public administration – prone to corruption etc. But, there is a reason for optimism. A survey on the unofficial economy in Croatia in the period 1990 – 2000, demonstrates that measured by using the method of discrepancies in national accounts, it declined from some 25% in the period 1990 – 1995 to 10% of GDP in the period 1996 – 2000 (Ott, 2002).

One of the factors that influenced this slowdown was the revised tax system, particularly the introduction of VAT, which resulted in improved tax collection and tax controls and might have

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also been a sign of a more efficient operation of the Tax Administration itself. Nevertheless, Croatian tax officials face two main problems: on the one hand, people are not accustomed to pay explicit taxes, and on the other, people are not willing to pay taxes at all. Even the best and most honest tax administration is helpless with low levels of tax morale or tax compliance. This theme is explored in section 3.

THE RELATIONSHIP BETWEEN THE TAXATION SYSTEM AND TAX MORALE OR TAX COMPLIANCE

It is very difficult to define culture and one can say that there are as many definitions as there are authors. The social norm (or custom), as propounded by Akerlof (1980), is *an act whose utility to the agent performing it in some way depends on the beliefs or actions of other members of the community*. Accordingly, conformity to social norms is characterized by mass behaviour. From it one could derive a definition of *tax morale* as a term connected with a certain "willingness to pay taxes" or acceptance of obligations to the state or to the community.

As stressed by Bird et al. (2008) the "dominant policy ideas in different countries – on the subject of equity and fairness, efficiency, and growth – like the dominant economic and social *interests* – capital, labour, regional, ethnic, rich, poor – and the key *institutions* – political (democracy, decentralization, budgetary) and economic (free trade, protectionism, macroeconomic policy, market structure) – all interact in the formulation and implementation of tax policy", which directly influence tax culture and determine the willingness to pay taxes.

Nerrè, (2002) defines tax culture as the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country's culture, including the dependencies and ties caused by their ongoing interaction. He believes that tax culture is broader than "culture of *taxation*" and "*tax-paying* culture". A consumer is more likely to obey the social norm and refuse to take part in collaborative tax evasion if there are enough other customers who will do so as well. Sufficient co-operators will generate a snowballing (or critical-mass) force that will defeat collaborative tax evasion. On the contrary, if the social norm cannot adopt a sufficient sanction against disobedience, the norm will erode and collaborative tax evasion will become widespread. Chang and Lai (2004) underline that *if the venal consumers overwhelm the economy, then the social norms tend to intensify the extent of collaborative tax evasion*. Once this intensified effect outweighs the usual deterrent effect of raising fines on tax evasion, there will

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be higher rather than lower tax non-compliance. In other words, to secure compliance, tax systems must, over time, represent the basic values of at least a minimum supporting coalition of the population.

As tax culture is determined by formal and informal institutions that change slowly, it is necessary to analyse succinctly the development of the tax system in Croatia. The "Kingdom of Serbs, Croats and Slovenes" established after the end of First World War, changed its name to the Kingdom of Yugoslavia in 1929. It had no common history, language or religion. It had come into being on the initiatives of Slovenes and Croats from Austro-Hungary (that mostly inherited adequate *K und K* tax culture but not efficient public administration). The political process of decision making and defining tax structures included patronage, bribery, gerrymandering, rigged elections, unfair electoral laws, and when necessary, the use of the coercive force of the police and *gendarmérie*.

The majority of the population were poor peasants who practiced an essentially subsistence type of agriculture – without any serious help from the government, but with a disproportionate share of the tax load (Stavrianos, 2002). The total tax burden on the peasant amounted at least 40-50% of their total cash which was extremely heavy in relation to the low productivity and related low aggregate income of the agricultural population. On the other side, there was reckless spending and the privileged positions of politicians. For example, every politician was eligible for a lifelong pension after having served as a minister or an undersecretary for one year. Thus, peasants, especially in Croatia, continued to begrudge the expenditures of vast sums on the army and bureaucracy, while they who paid the most taxes, received virtually nothing in return. There was also the same resentment against the high tariffs and government monopolies which raised the prices of necessities such as matches, sugar, tobacco, and farm implements.

After the Second World War a second Yugoslav state was established, as a socialist federation of six republics, one of which was Croatia. At that time the federal government's revenue consisted mostly of the basic sales tax, an indirect means of taxation. The republics – among them Croatia – levied a special sales tax and other indirect taxes. Yugoslavia introduced a *self-management system* where the employees had the impression (better to say illusion) that they really governed the firms. But the system had a high degree of bureaucratization and was extremely dependant on the State for finance. It lived on the credits accorded to it by the State and was free to dispose of only a small part of its profit, the rest being paid to the

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Treasury in the form of tax. Revenue derived from the self-management sector were used by the State not only to develop the backward sectors of the economy and underdeveloped parts of the Federal State, but also to pay for the heavily bureaucratized government apparatus, the army, the police forces and for the prestige expenditures, which were often quite excessive. On the one hand, this caused the further deterioration of tax morale, and on the other, the creation of powerful privileged groups in society that were fully against any political and economic change.

Already in Yugoslavian times, during the 1980s, various federal commissions discussed for example the introduction of unified income taxation and VAT in Yugoslavia. Croatian experts worked closely with experts from other republics in those commissions. In the period after the collapse of the former Yugoslavia, with the assistance of foreign advisors, a very modern (from a Western point of view) tax system was established in Croatia. But the way to comprehensive reform was rocky.

Tax reform in Croatia finally manifested itself in the publishing of The Income Tax Act (*Zakon o porezu na dohodak*) and The Profit Tax Act (*Zakon o porezu na dobit*) (OG 109/93), which came into force on January 1, 1994, and abolished the 1991 Direct Tax Act. Croatia is the only country in transition that has introduced personal income surtax at the sub national level⁴ (Martinet-Vazquez and McNab, 2000). Also an Excise Tax Act was accepted at the same time (OG 51/94). With advice from a German expert group gathered around Manfred Rose, a completely new and consumption-oriented tax system was introduced. The proposed tax system was deemed to be simple and fair, and exempted dividends and interest payments from taxation. The existing scheduling tax system (where revenue from each source is taxed separately) was changed into one with synthetic taxation of income. Besides this direct consumption tax, a VAT was finally implemented in 1998. It is hard to estimate the adequacy and compatibility of the proposed tax system to the existing Croatian tax culture, but probably local or cultural constraints were mostly neglected (or at least not very much respected) by Rose and his team.

How can one assess the impact of the existing tax system to tax culture and vice-versa, especially having in mind the obstacles and the unwillingness of Croats to pay taxes? Probably, the best way would be to analyze principles, the economic effects of the tax system and possible changes in the tax burden. The main principles on which the Croatian tax system was established (by introducing a tax reform ten years ago) are still broadly observed, despite the deviations caused by current economic and political changes. While some of the changes represent a move in the right direction (e.g. decreas-

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ing of the tax burden, giving priority to consumption taxation over taxation of income and savings, reducing tax evasion, improving the efficiency of tax administration), other changes that have already been effected or announced should be reconsidered carefully while making realistic estimates of the fiscal consequences resulting from their implementation. This relates to the introduction of new forms of tax allowances and exemptions, additional tax rates, e.g. the income tax or VAT rate, reduction of the VAT rate and the introduction of new taxes.

The tax burden expressed as a share of taxes and social security contributions in GDP at the consolidated general government level has gradually decreased and is almost equal to that in EU Member States. The share of total social security contributions in the Croatian GDP has also decreased and is approximately 1 percentage point higher than in EU Member States. This favourable trend resulted from reducing the total rates of social security contributions from wages and on wages from 43.4% in 1995 to 37.2% in 2008. This change was by any measure beneficial as it led to a reduction in labour costs and improved the competitiveness of Croatian export products. However, the perceived tax burden, according to the majority of Croatian people, is still very high.

To sum up, Croatian tax culture has been influenced by Austrian/Hungarian taxation at the time of the Monarchy, with an undeveloped democratic and political system in the Kingdom between the World Wars and by tax laws authorized by the federal bodies after the Second World War. Throughout history indirect means of taxation have significantly dominated direct ones. Transition also created significant changes in the tax system. The majority of new tax laws were passed and new taxes were introduced during the early and mid-1990s when Croatia simultaneously had to make the transition and carry on the war. Low levels of tax morale and fierce tax resistance have been prevalent and not only during the days of the Federal Republic when this was apparently due to bad taxation techniques. Maybe the low level of tax morale and tax compliance is caused by the high distrust of citizens towards the Government, which we analyze in the next Section.

THE EXTENT OF TAX EVASION OR TYPES OF TAX MORALS AND DIFFERENT CULTURES OF TRUST AND DISTRUST IN CROATIA

More than 10 years ago, Tanzi and Shome (1993) argued that tax evasion is related to tax structures, types of income, and social attitudes. The methods of tax collection, such as cross tax-control between the seller and the buyer, presumptive taxes, and the imposition of withholding taxes, all play a role

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in determining the level of tax evasion. That is to say, a traditional tax evasion framework may be too simple to be of much practical use, particularly from the perspective of countries in transition. Thus, the importance of culture, specific social values, institutions, and customs (traditions) to economic growth, competitiveness and political development on the one hand and tax evasion on the other is almost no longer questioned. There are a number of reasons for this, but most often they involve the unsatisfactory level of social capital and the non-existence of public confidence⁵ (Fukuyama, 2000), caused by the high costs of transition.⁶ According to social capital theorists (Coleman, 1990; Putnam, 1993), its characteristics are mutual trust, generally-accepted norms for cooperation and social networking and ties among members of a community.

In his well-known study on Italy's development, Putnam (1993) states that the totality of these characteristics – social capital – is the driver of economic growth and political stability. Uslaner (2004) examines the relationship between corruption and trust. Corruption is illegal (or barely legal) behaviour by political elites, to manipulate the affairs of state for private gain. Obviously the two are strongly related: trusting societies have less corruption. People who have faith in others are more likely to endorse strong standards of moral and legal behaviour. Alternatively, people who believe that the legal system (or the tax system as an important part) is fair and impartial are more likely to trust their fellow citizens and their governments. Societies with more generalized trust are less corrupt.

Unfortunately, South Eastern Europe is characterized by a growing gap that divides the public from elites and a growing mistrust that the public feels towards democratic institutions (Krastev, 2002). It is almost boring to reiterate the low level against the importance of trust and social capital especially in transition countries. Several research studies have indicated weak institutions and a visibly lower level of social capital in almost all transition countries (Grootaert and van Bastelaer, 2002; Troiani, 2003). These countries often uncritically and directly apply specific models from successful Western, formal market institutions (laws, regulations) onto a different transition socio-economic system, which not only fails to produce the desired success, but also leads to extensive transitional anomie as a result of crumbling basic informal institutions.

The level of trust is also an indicator of institutional development. Croatia has a considerably low level of mutual trust among its overall population. According to research conducted by Rimac and Štulhofer (2002), generalized trust⁷

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in Croatia is two times lower than the EU average. Furthermore, in terms of trust in the country's political institutions,⁸ Croatia stands roughly at the average of countries about to join the EU, but it lies far below the average of member states. An almost crucial issue in behaviour and the decision to comply with or violate the law and obligations is the question of justice and validity of social norms, so that confidence in existing norms is an important indicator of social trust. The more individuals personally perceive widespread violation of norms, the less likely such individuals are to have confidence in them. Trust in norms is highest in Germany, Denmark and Sweden, while in Croatia it is somewhere between the average of EU member states and EU candidate countries. In earlier research, Rimac and Štulhofer (2002) found a relatively high level of opportunism,⁹ especially among youth, so there is a real danger of the long-term maintenance of the current state of affairs. This is why the consistent prevention of illegal behaviour¹⁰ and corruption¹¹ — particularly the limitation of the opportunity and need for its very emergence — is so necessary and important.

The trust of citizens in the government and governmental bodies in Croatia is relatively low. For the general public there is perception that employees in governmental bodies are badly paid, un-motivated and incapable of the duties that they perform. For a long period, employment in governmental and state bodies depended on membership of political parties. Capable and knowledgeable employees have been leaving state bodies. In *The Survey Civil Society 2004*, it was shown that 82.7% of citizens do not have trust in the Government of Croatia (Bežovan et al., 2005).

Of the complex determinants of (dis)trust in the Government, one could also include widespread corruption and the perception of income inequality. Corruption is generally considered to be a curse. It ruins rules of fairness and bestows advantages on some people that others do not have. Corruption transfers resources from the mass public to the elites — and mostly from the worse off to the better off. It acts as an extra tax on citizens, leaving less money for public expenditure. Corrupt governments have less money to spend on their own projects — especially protection of the poor. The conditions pushing down the salaries of public employees and lower-level staffers will also be more likely to extort funds from the public purse. Government employees in corrupt societies will thus spend more time filling their own pockets than serving the public. Briefly, corruption leads to lower levels of economic growth and to the creation of insecurity because people realize that they are not the masters of their own fate.

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Honest government makes people feel that they are in control of their own fate – and do not need to take advantage of others. In Croatia there are constant Governmental activities and lip-service directed towards the reduction of corruption, although there is evidence that the situation is far from improving. Croats believe that corruption is not reducing and that they are treated unfairly by the public officials or in the courts.¹² Thus, they are less likely to have faith in the legal system and in the Government.

Also, according to Uslaner (2005) *generalized trust rests upon the psychological foundations of optimism and control and the economic foundation of an equitable distribution of resources*. Furthermore, more inequality leads to more corruption (or less transparency).

However, in spite of the general perception that inequality in Croatia increased strongly during the transition period, the evidence suggests that it did not rise tremendously. Thus, the Gini coefficient rose from 0.286 in 1988 to 0.297 in 1998. Decomposition of Gini changes show that the expansion of social transfers as well as the absence of stronger rises in wage concentration account for only a mild increase in inequality. Nestić (2005) finds that in the 1998 – 2002 period the inequality in the distribution of overall income is slightly on the rise, but still far from spectacular. One should also not forget that the Croatian welfare system is quite effective and efficient in reducing extreme poverty and income inequality (Šućur, 2005).

Uslaner (2003) reminds us that citizens have a "condition contract" with the state: They agree to obey the laws and pay the taxes if the government provides at least basic services including the rule of law and security of life and assets. Higher levels of trust in government are associated with stronger demands on citizenship and should be linked with an easier bearing of the tax burden. If the state does not respect and perform its duties, citizens will lose trust in it and/or will not pay taxes. On a social opportunism index scale, Croatia scores worst of a sample of 5 transition and 5 EU countries. Alarming, a public attitude towards evaders is rather positive, and sympathy is even higher among the younger generation than among elderly people (Štulhofer and Rimac, 2002). This expresses the common distrust of political institutions in Croatia, which is stable or even rising.

Reviewing Croatian history reveals that evasion seems to have been already prevalent in earlier times. As Croats believe that they have been let down by their Government, it seems to be quite obvious that tax evasion is a widespread phenomenon. As the younger generation are more inclined towards opportunism and tax evasion, one could assume that Croats are a long way off from the development of the social fabric necessary for a civic culture.

PROPOSALS FOR IMPROVEMENT AND CONCLUSIONS

The success of all reform depends on strengthening the rule of law. In this, the Government and its high functionaries should act as an example. The essential adjustments must be institutional and not just in the letter of the law. In order to restore the trust of citizens, it is essential to have an effective executive branch, greater professionalism, more transparent work by ministries and the Government, and precise definitions of and criteria of and for accountability. In order to increase trust in institutions in Croatia (and so indirectly in the EU as well) a successful fight against corruption is essential.

Of particular importance would be to stop the practice of continual changes in the tax system and to improve the efficacy of the tax authorities themselves. Because of the many changes in the last couple of years it is necessary to ensure a more neutral tax system that will, to the least possible extent, influence economic decision making and in which tax bases will be as broad as possible, with as few exemptions and privileges as possible; and with the tax system not being used to carry out governmental social, economic and development policies. This means no additional tax concessions, tax credits, and allowances for individual industries, regions or occupations. On the contrary, the aim should be to abolish existing privileges. The tax system should be as stable as possible, the tax and regulatory burden as low as possible, together with an increase in the probability of tax evasion being detected and penalised and with a build up of an appropriate public spending structure and an increase in the quality of public services together with a strengthening of the general awareness of the need to pay taxes.

It is important to systematically begin with monitoring, analyzing and determining the wages and salaries in tax administration (and after that in the whole public sector) where more attention should be directed towards working outcomes and not just the working experience of individual employees. Pay rises in public administration might reduce inefficiency and corruption, but only to a limited extent. The first line of defence has to be internal control together with the existence of an ethical code and systematic and objective output monitoring and measuring. In the long run, next to the strengthening of the rule of law and the depoliticization of public administration, it is necessary to open up the latter to the public; increase the motivation of civil servants for their work, provide continuous training and education of public servants and accept additional criteria for promotion in the civil service. All these measures should contribute to suppression of corruption and the development of a new culture among civil

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servants. They should be more public-oriented and more interested in results, which can be achieved with stimuli that are not necessarily related to pay, such as public recognition and awards. While fast change is impossible (given the need to organize adequate undergraduate and postgraduate studies, serious improvements in working conditions and similar actions) it is necessary to start as soon as possible.

Finally, it is necessary to develop a general level of awareness that the non-payment of taxes and contributions is not the heroic act of an individual or a manner of righting a wrong imposed by the state, but the shifting of the obligation of payment to another person. The successful fulfilment of the obligation to pay taxes and contributions can be an important step to the implementation of the rule of law and order and respect for the law in Croatia.

NOTES

¹ It is necessary to be honest and to say that the situation with budget transparency has improved in the last few years and more and timelier data are now available at the national level. There is an obvious step forward in culture by releasing a lot of information publicly with especially the Ministry of Finance posting extensive budget related information on its website. In the 2008 research cycle, which refers to the fiscal year 2007, the Croatian index came to 59, which is certainly an advance on the previous research cycle, relating to the fiscal year 2004, when the score was 42. In spite of an improvement of 17 points, Croatia is still placed in the group of countries that provide their citizens with only "some information" (Badun and Urban, 2009).

² As being the most corrupt, respondents from Croatia have singled out the judiciary, following political parties, parliament, tax authorities, the economy, customs, police and health care services (Vasiljević, 2005).

³ Unlike the Bulgarian National Revenue Agency and the Romanian National Agency for Fiscal Administration, who have adopted an operational strategy, Croatia is in the process of drafting a strategy to improve tax collection. Training of tax officials has been established in all three countries, although the EC monitoring and progress reports have recently indicated that administrative capacity in the tax administrations of each country has room for further improvement (OECD, 2006).

⁴ Local surcharges are for municipality up to 10% of state income tax (SIT), for town under 30,000 inhabitants up to 12% of SIT, for town over 30,000 inhabitants up to 15% of SIT, and for capital Zagreb up to 30% of SIT.

⁵ A successful, competitive and well-organized society is often characterized by a high level of trust in people and those exercising governmental authority, and honesty and accountability in the public sphere. Trust in people is crucial to the creation of ties between various social groups. Trust in the State is crucial to political stability and the observance of laws.

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⁶ Transaction costs are necessary in the conveyance of property rights from one economic agent to another. They include production costs, conversion costs (meaning detection of the possibility of conversion, the necessary negotiations, oversight and implementation) and the costs of preserving and protecting the institutional system (courts, police, armed forces). North (1997) defines transaction costs "as the costs of measuring and implementing agreements." In modern economies increasing emphasis is placed on transaction costs, so that they are becoming equal in importance to, and sometimes even surpass, production costs.

⁷ Generalized trust is obtained with the help of the question: "In general, would you say that most people can be trusted, or does a person have to be cautious in relations with others?"

⁸ The Church, military, the educational system, the press, trade unions, the police, Parliament, public services, the social security system, and the health-care and justice systems.

⁹ By accepting the following propositions: *Evade taxes, if you're able and Take bribes at work.*

¹⁰ Greater and longer lasting non-observance of laws means destruction of the entire social fabric and the undermining of achievements made over the long run. This is fertile ground for the emergence of corruption, which disrupts economic flows, creates its own "rules and laws," accepts unlawful behavior as normal, creates new centers of power and dissolves any trust in existing institutions and authorities.

¹¹ Corruption emerges as an overlapping of the public and private: a public official makes a discretionary decision on whether an individual will exercise a certain right. Laws must therefore be clear and durable, leaving the least possible room for discretionary action, while decisions must be made on the basis of clear criteria, and be transparent and accessible to the public. All of this is frequently not the case in Croatia.

¹² However, this general impression is not confirmed by the Transparency International Corruption Perception Index (CPI) that placed Croatia in 2008 62nd out of 180 countries with the score 4.4. That is an improvement in comparison with 2005, when Croatia was 70th out of 158 countries with the score 3.4. The CPI Score relates to perceptions of the degree of corruption as seen by business people and country analysts and ranges between 10 (highly clean) and 0 (highly corrupt) (Transparency International, 2008).

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Porezna evazija, kapacitet države i povjerenje u zemljama u tranziciji: slučaj Hrvatske

Predrag BEJAKOVIĆ
Institut za javne financije, Zagreb

Porezna evazija ozbiljan je problem za većinu zemalja u tranziciji, uključujući Hrvatsku, koji otežava ostvarivanje temeljnih zadataka države. U radu se razmatraju problemi prikupljanja poreza i njihov odnos s kapacitetom države. Pozornost je usmjerena i na odnos poreznoga sustava i poreznoga morala ili ispunjavanja porezne obveze, kao i na analizu opsega porezne evazije (utaje), vrste poreznoga morala i raznih kultura povjerenja i nepovjerenja u Hrvatskoj. Završni dio sadrži zaključke i prijedloge mjera.

Ključne riječi: porezna evazija, porezna kultura, kapacitet države, Hrvatska

Steuerhinterziehung, Staatskapazität und Vertrauensverhältnis in Transitionsländern: Fallbeispiel Kroatien

Predrag BEJAKOVIĆ
Institut für öffentliche Finanzen, Zagreb

Steuerhinterziehung ist für die Mehrheit der Transitionsländer einschließlich Kroatien ein sehr ernstes Problem, das die Ausübung der grundlegenden Funktionen eines Staates erschwert. In seiner Arbeit untersucht der Autor verschiedene

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Probleme bei der Steuererhebung und entsprechende Bezüge zur Staatskapazität. Des Weiteren gilt seine Aufmerksamkeit dem Verhältnis von Steuersystem und Steuermoral bzw. der Erfüllung der Steuerpflicht. Es folgt eine Analyse zum Umfang der Steuerhinterziehung, zu Arten der Steuermoral und verschiedenen Formen der Vertrauenskultur bzw. des fehlenden Vertrauens in Kroatien. Abschließend präsentiert der Autor eine Schlussfolgerung und schlägt Maßnahmen zur Bekämpfung der angesprochenen Probleme vor.

Schlüsselbegriffe: Steuerhinterziehung, Steuerkultur, Staatskapazität, Kroatien